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SENSITIVE

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TREASURY FOR U/S TAYLOR AND OASIA - MILLS  
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SUBJECT: TURKEY'S ECONOMY MARCH 6 COB: RETURN OF COMPLACENCY

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"Never Never Land in Our Markets"

1. (U) On March 6, Turkish financial markets were stable. The lira remained unchanged at TL 1, 608,000 to the dollar. Yields on lira-denominated T-bills strengthened slightly to 57.5 percent compounded (yesterday's close was 58 percent). The Istanbul Stock Exchange closed up 0.2 percent.

2. (SBU) Lehman Bros Turkey analyst Tolga Ediz told us Turkish markets are living in "never never land" where all hopes rest with the U.S. financial package coming true. Ediz added that "as long as U.S. ships are anchored off the Turkish coast," market participants will continue to believe. Further confirmation comes from Turkish press reports of ongoing site prep work. Some foreign funds are getting back into Turkish markets on the prospect of the U.S. package, he said.

3. (SBU) Comment: After reaching quick agreement with IMF staff on the budget overnight March 2, a mood of complacency seems to have returned to the GOT, and is settling on the markets as well. IMF staff in Ankara report no further progress on finalizing the draft LOI (more IMF readout March 7). All this leaves open the prospect of Turkey entering next week with no agreement on the IMF Fourth Review, and no actual progress towards a U.S. package. Bender Securities analyst Murat Golkan volunteered to us March 6 that this prospect concerns him, though he said he appears to be a lone voice. Asked about possible market reaction to such a worst case scenario, Golkan said "meltdown." End Comment.

Meanwhile World Bank Prepares to Cancel Pending Loans

4. (SBU) The World Bank's Country Director for Turkey Ajay Chhibber told us March 6 that the World Bank is moving to cancel \$1.375 billion in pending loans that are due to expire on March 31. The reason is World Bank unhappiness with the 2003 budget, which postpones the "Direct Income Support" payments to farmers (TL 1.4 quadrillion) into 2004. Chhibber said he had instructions from headquarters to publicly come out against the budget, but he is holding off. He told MinState Babacan this week that unless the GOT put back in the 2003 budget at least TL 1 quadrillion (about \$600 million), then the pending loans would be canceled. Babacan said he would come back to Chhibber.

5. (SBU) The World Bank's assessment, per Chhibber, is that this government is highly unlikely to do any significant reforms in 2003. The Bank will seek to limit further exposure to Turkey this year (both its \$1.375 billion in direct budget loan programs and some of its \$600 million in project financing), and "keep powder dry" for 2004. "They would waste the money anyway," he concluded.

6. (SBU) Comment: The World Bank theoretically has a high loan limit for Turkey (\$5 billion over three years under its "high case" scenario, which it is now downgrading), but in fact the Bank only disbursed a total of \$680 million to Turkey in 2002, and about \$1 billion in 2001. So downgrading its presence in Turkey would not have an immediate, large effect on budget financing. The bigger impact of such a move would be on market confidence, and then only if the Bank publicized its discontent.

